



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Resolution of Intention to Form a Convention Center Facilities District

OVERVIEW

On October 25, 2011, the City Council approved a Procedural Ordinance which amended the Municipal Code to incorporate certain provisions of the Mello-Roos Act in order to establish the legal framework for creating a Convention Center Facilities District (CCFD). CCFD revenues are anticipated to provide a majority of funding for the proposed San Diego Convention Center Phase III Expansion Project ("Expansion Project").

Following the process outlined in the Procedural Ordinance, the current action requests City Council approval of a Resolution of Intention to Form the CCFD and levy a special tax within the district. In addition, the Council is requested to approve a resolution declaring the need to incur bonded indebtedness in an amount not to exceed \$575 million in connection with funding the Expansion Project.

When the City Council introduced the Procedural Ordinance on October 10, the IBA expressed concern regarding the lack of a comprehensive financing plan for the Expansion Project. While it was recognized that a number of funding sources were still being explored and would progress on parallel tracks, the IBA recommended that a more complete financing plan be provided when the Resolution of Intention was brought forward for Council approval. On November 23, 2011, the Chief Operating Officer and Chief Financial Officer issued a memo that provided a conceptual overview of the financing approach being considered for the Expansion Project. However, a number of questions remain regarding the financing plan for the Expansion Project, and the extent of the financial obligation that will be expected from the City.

This report provides an overview of the requested actions related to the Resolution of Intention and the resolution declaring the need for bonded indebtedness, and reviews the proposed funding sources described in the November 23 memo.

FISCAL/POLICY DISCUSSION

The current estimated cost of the Expansion Project is \$520 million, which includes a \$20 million contingency. As previously discussed on a number of occasions, it is anticipated that a majority of the cost will be funded by a special tax levied pursuant to the creation of a Convention Center Facility District. The current action requests Council approval of a Resolution of Intention to establish Convention Center Facilities District No. 2012-1, and to adopt a resolution declaring the need to incur bonded indebtedness to finance the Expansion Project.

Adoption of the Resolution of Intention is a procedural step required by the Municipal Code pursuant to the Procedural Ordinance adopted on October 25. It is important to note that while adoption of the Resolution of Intention will initiate the proceedings for establishing the CCFD, it does not commit the City to any particular course of action. However, the Resolution of Intention will do a number of things, including:

- Establish the boundaries of the territory proposed for inclusion in the CCFD, which are proposed to be coterminous with the boundaries of the City;
- Define that the facility to be financed by the CCFD will be “[T]he contiguous expansion, construction, reconstruction, rehabilitation, replacement, equipping, upgrade and related expenditures...of the existing San Diego Convention Center.”;
- Establish the Rate and Method of Apportionment, discussed further below, and the manner of collection of the special tax;
- Set the date and time for a public hearing on the establishment of the CCFD, which is proposed to be Tuesday, January 24, 2012 at 2:00 p.m.;

The resolution declaring the needs to incur bonded indebtedness is also a procedural step required by the Municipal Code. Most importantly, this resolution would establish that the amount of the proposed bonded indebtedness issued by the CCFD to finance the construction of the Expansion Project shall not exceed \$575 million. This represents the absolute maximum amount that the CCFD can borrow by issuing bonds for the construction of the Expansion Project; however, staff has indicated that the actual size of a future bond issuance will likely be somewhat less than this amount. Future Council action will be required prior to any bond issuance.

One of the most significant aspects of the Resolution of Intention is the Rate and Method of Apportionment (R&MA), which establishes the parcels that will be subject to the special tax, how the special tax will be applied, and the tax rate(s) that will be levied. Under the R&MA, all assessor parcels that are classified as Hotel Properties will be subject to the special tax beginning in FY 2013. As conceptually discussed on a number of occasions, the R&MA establishes three distinct and mutually exclusive zones. Zone 3 encompasses the downtown area, which has the closest proximity to the Convention Center. Zone 2 generally encompasses area on the periphery of downtown, including Mission Valley, Hotel Circle, Mission Bay and Harbor Island, and Zone 1 encompasses all areas not in Zone 2 or Zone 3. Under the R&MA, Hotel Properties in Zone 3 will be subject to a tax rate of 3%, Hotel Properties in Zone 2 will be subject to a tax rate of 2%, and Hotel Properties in Zone 1 will be subject to tax rate of 1%.

The Resolution of Intention also specifies that at the public hearing the Council will only be able to reduce the special tax rates established in the R&MA, but not increase them. In addition, the Council will be able to change the territory of the District or any of the zones, but not in a manner that would increase the special tax rate for any of the Hotel Properties. For example, the Council would not be able to expand Zone 3 (and the associated 3% tax rate) to include Hotel Properties that are currently within Zone 2 or Zone 1. Importantly, however, the IBA has confirmed with the City Attorney’s Office that the City Council may make changes to the special tax rates or the zones as currently proposed in the R&MA prior to adopting the Resolution of Intention.

Financing Plan for the San Diego Convention Center Phase III Expansion Project

When the Procedural Ordinance was introduced by the Council on October 10, the IBA noted a concern regarding the lack of a comprehensive financing plan for the Phase III Expansion. While we recognized that a number of funding sources were being explored and would progress on parallel tracks, we recommended that a more complete funding plan be provided when the Resolution of Intention was brought forward for Council approval, including how much funding is expected to come from each source, the steps required for implementation, and any contingencies that are being considered.

On November 23, 2011, the Chief Operating Officer and Chief Financial Officer issued a memo that provided additional information on the conceptual financing approach that is being considered. The memo outlined four funding sources that are being contemplated to finance the proposed Expansion Project: CCFD special tax revenues, San Diego Unified Port District contribution, Redevelopment Agency funds, and City TOT revenues.

Based on the zones and special tax rates as set forth in the R&MA, staff has estimated that total revenues from the CCFD would be approximately \$29.4 million in FY 2013¹. This revenue is projected to grow annually at the same rate of growth projected for City TOT revenue in the 5-Year Financial Outlook, reaching an estimated \$36.6 million by FY 2017. Thereafter, CCFD special tax revenue is conservatively assumed to experience 0% growth for the life of the District. This is reflected in the table below:

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	...	FY 2044
CCFD Revenues	\$ 14.7	\$ 30.9	\$ 32.6	\$ 34.5	\$ 36.6	\$ 36.6		\$ 36.6
<i>% Growth</i>	<i>N/A</i>	<i>5.0%</i>	<i>5.5%</i>	<i>6.0%</i>	<i>6.0%</i>	<i>0.0%</i>		<i>0.0%</i>

According to the November 23 memo, the Mayor has requested that the Port District provide an annual contribution of \$3 million for a period of 20 years, which was conditionally approved by the Board of Port Commissioners on November 29. The memo further indicates that a \$2 – \$4 million annual contribution from the Redevelopment Agency may be possible beginning in FY 2025 pending the outcome of the California Supreme Court case, while an additional \$2 million in one-time Redevelopment funds may also be available. Finally, the memo suggests that the

¹ The November 23 memo reflects \$14.7 million for FY 2013, which represents a half year collection. The figure reflected in this report is annualized. It is not yet known precisely when collection of the CCFD special tax would begin.

remaining gap would be filled with City “incremental” TOT revenue, projected to be approximately \$3.5 million for 30 years.

An important concept discussed in the memo is that of “incremental” TOT revenue. A November 2010 economic analysis of the proposed Convention Center Expansion by AECOM estimates that the City will realize an additional \$13.8 million in annual revenue as a result of the Expansion Project, including \$12.7 million in additional TOT revenue and \$0.8 million in additional sales tax revenue. As a result, the November 23 memo characterizes the City’s TOT contribution as revenue that “would not be available but for the Expansion Project.” While it is certainly expected that the expansion of the Convention Center would have a positive economic impact and generate additional tax revenues for the City, it is extremely difficult to estimate such impacts with any degree of accuracy.

A number of additional observations regarding the conceptual funding plan outlined in the November 23 memo are provided below:

- The requested contribution from the Port District is only for a 20 year term, while a 30 year bond is contemplated. As such, Port funding will not be available for the life of the bond. It is unclear why only a 20 year funding commitment was sought from the Port District.
- Depending upon the outcome of the ongoing Supreme Court Case, redevelopment agencies may no longer be in existence, which would jeopardize that potential funding source. Even if a favorable decision is reached in the Supreme Court case and the City’s Redevelopment Agency continues to exist, it is possible that there may be additional attempts by the State to dissolve redevelopment agencies in the future.
- It is possible that more than \$3.5 million in City TOT revenue will be required annually. Since no other significant funding sources have been identified, if any of the other funding sources discussed in the memo do not materialize (such as Redevelopment funds), the contribution from “incremental” City TOT revenues may need to increase. Furthermore, it is unclear whether the funding sources discussed in the memo will be sufficient to cover the annual debt service on the Convention Center Expansion bond, particularly in the first several years.
- Finally, the assumption of 0% growth in CCFD revenue from FY 2018 – FY 2043 is very conservative and highly improbable. Even if a modest average annual growth of 2% were to be realized (which is likely still conservative), projected CCFD revenue would increase significantly. While growth in CCFD revenue could potentially be sufficient to offset City TOT contributions or cover any funding shortfalls, staff has indicated that the hotel industry will likely expect a minimum financial commitment from the City, even if CCFD revenues exceed projections.

Staff has indicated that the financing plan continues to be a work in progress, and that a number of different options are being explored to determine the financing structure that best fits the Expansion Project’s needs and projected cash flow. While we recognize that the current requested Council actions are largely procedural, we would have preferred that a comprehensive

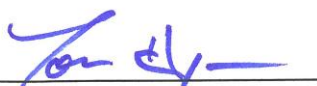
financial plan be available at this point in the process, since a number of important parameters such as the special tax rates and overall debt limit will be established by these actions.

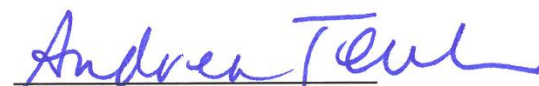
Overall, the IBA's primary concern is in being able to determine whether the Expansion Project is financially feasible, and understanding the full extent of the City's expected financial obligation. While the November 23 memo provides additional information on the conceptual financing approach that is being contemplated, we do not believe that sufficient information has been provided to make a determination on either of these issues at this point in time. Nevertheless, it is important to reiterate that the current actions do not commit the City to any particular course of action.

CONCLUSION

The current actions request City Council approval of a Resolution of Intention to Establish a Convention Center Facilities District and resolution declaring the need to incur bonded indebtedness. These actions are procedural steps required by the Municipal Code in the process of establishing a Convention Center Facilities Financing District. The Resolution of Intention establishes that the boundaries of the CCFD are coterminous with boundaries of the City, defines the facility to be constructed as the contiguous expansion of the San Diego Convention Center, and sets a public hearing on the establishment of the CCFD for January 24, 2012 at 2:00 p.m. In addition, the Resolution of Intention establishes the Rate and Method of Apportionment, which defines the parcels that will be subject to the special tax, how the special tax will be applied, and the tax rate(s) that will be levied. The resolution declaring the need to incur bonded indebtedness establishes a limit of \$575 million on any bonded indebtedness that may be issued by the CCFD to finance the Expansion Project.

Previously, the IBA recommended that a more complete financing plan be provided when the Resolution of Intention was brought forward for Council approval. On November 23, 2011, the Chief Operating Officer and Chief Financial Officer issued a memo that provided a conceptual overview of the anticipated financing approach for the Expansion Project. The memo outlined four revenue sources being considered: CCFD special tax revenues, San Diego Unified Port District contribution, Redevelopment Agency funds, and "incremental" City TOT revenues. While the memo provides more information than was previously available, the IBA does not believe that sufficient information has been provided at this time to make a determination on whether the Expansion Project is financially feasible, or to understand the full extent of the City expected financial obligation.


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